Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Perata	Analyst:	Jane Tolman	Bill Number:	SB 145
Related Bills:	None	Telephone:	845-6111	Amendment Date:	01/29/2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Conformity To Federal Penalty For Underpayment Of Estimated Tax

SUMMARY

This bill would increase the amount of tax required to be paid throughout the year by withholding or estimated tax payments.

This analysis will not address the bill's sales tax provision, as it does not impact the Franchise Tax Board or state income tax revenue.

SUMMARY OF AMENDMENTS

The January 29, 2002, amendments added the provisions discussed in this analysis.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

The purpose of this provision of the bill appears to be to accelerate the timing of when income taxes are paid to the state.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2003, and operative for taxable years beginning on or after January 1, 2004.

POSITION

Pending.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Alan Hunter for GHG	03/27/02
____ SA	____ O	____ NAR		
____ N	____ OUA	__X__ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Under federal law, taxpayers are required to pay the majority of their tax liability over the course of their taxable year by either having money withheld from their wages or by making estimated tax payments. A penalty ("addition to tax") may be imposed on any taxpayer who fails to make these payments. A taxpayer generally does not have an underpayment of estimated tax under two circumstances:

- If the individual's required estimated tax for the year is less than $1,000, or

- If the individual makes timely estimated tax payments (required payments) at least equal to:

  1) 90% of the tax shown on the return for the current year, or

  2) 100% of the tax shown on the return for the preceding year. (A special rule applies to high-income taxpayers with adjusted gross income over $150,000 ($75,000 if married filing a separate return). Effective for the year 2002 and thereafter, these taxpayers do not have an underpayment if they make payments of 110% of their tax for the preceding year.)

Federal law requires that alternative minimum tax be included when calculating whether the taxpayer has paid the correct amount of estimated tax.

Current California law conforms, in part, with federal rules relating to the payment of estimated tax by individuals. However, there are several significant differences:

- The "required payment" is based upon 80% of the current year tax instead of the federal 90%.
- The "required payment" does not include alternative minimum tax.
- Estimated payments are required, unless the tax due for the year is less than $200 as opposed to the federal $1,000.
- No penalty will be assessed if 80% of the current or prior year tax is subject to withholding.
- No penalty will be assessed if 80% of the adjusted gross income consists of wages subject to withholding.

THIS BILL

This bill would conform to the federal law requiring 90% of the current year tax liability to be paid as estimated tax payments. This bill would eliminate the 80% withholding "safe harbor." Also, this bill would require alternative minimum tax to be included in the computation of required estimated tax payments.

Additionally, if a taxpayer underpaid the estimated tax because of the changes made by this bill, the underpayment penalty ("addition to tax") would be waived. This waiver would apply only to underpayments of tax or estimated tax made for the 2002 taxable year that are due before April 15, 2003.

IMPLEMENTATION CONSIDERATIONS

Implementation of this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

Existing California law requires that changes made to the laws regarding estimated tax payments shall be applied ("operative") to the first taxable year after the taxable year in which the bill becomes effective. This bill would become effective January 1, 2003, and operative for taxable years beginning on or after January 1, 2004. Therefore, the waiver provision for any period before April 15, 2003, is unnecessary and can be removed, as the bill will not apply to that period. If, on the other hand, the author intends the provision to become operative for taxable years beginning on or after January 1, 2003, and the bill is so amended, then this waiver provision might still be necessary.

OTHER STATES' INFORMATION

Illinois, Massachusetts, *Michigan, Minnesota,* and *New York* follow federal laws requiring 90% of the estimated tax to be paid through withholding or estimated payments and imposing a penalty for underpayment of estimated tax. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following cash-flow gains:

Estimated Accelerated Tax Payments Under SB 145 As Amended January 29, 2002 Effective for tax years BOA 1/1/2004 Enacted after 6/30/2002 $ Millions		
2003-04	2004-05	2005-06
$235	$15	$15

This estimate does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of the above changes in the required estimated payments is simulated for each Personal Income Tax (PIT) taxpayer in a large sample of PIT taxpayers for the 1999 tax year. These simulations take into account specific micro-economic data for each PIT taxpayer, such as adjusted gross income, wage, estimated payments, credits, alternative minimum tax, and other detailed tax data. The results of the simulations are weighted statistically to the population level. The revenue acceleration is estimated as the differences between the timing of tax payments simulated under current and proposed laws.

The Department of Finance's forecast of taxable liability was used to extrapolate the estimated result to future years.

This bill would require taxpayers to increase their rate of estimated payments from 80% of the current year tax to 90%, thus creating a cash-flow revenue gain in fiscal year 2003-4. Since the increased amount would have been collected in 2003-4, a smaller increases in tax payments would occur in 2004-5.

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